# Senate Democratic Policy Committee Hearing

## "An Oversight Hearing on the Bush Administration's Plans to Privatize Social Security"

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Senators, I know that the main purpose of this hearing is to explore the implications of the Social Security privatization proposals that may soon be before this body, but I'd like to start out today by first reminding everyone about the importance of our Social Security system.

Social Security is without a doubt the crown jewel of American social policy. While in need of strengthening, our "three legged stool" for retirement, made up of Social Security, private pensions and retirement savings, is the strongest retirement system in the world. And the centerpiece — the foundation on which our retirement system is based — is Social Security.

Without today's monthly Social Security payments, half of all seniors in America would be living in poverty. Social Security provides the foundation of support for tens of millions of Americans — with benefit protections available over a lifetime. Our social insurance system is critically important not only for older Americans, but also for the disabled, for widows and for families.

In addition, we know that many individuals are increasingly relying on individual savings for retirement security, given the shift of our private pension system away from defined benefits. Given the continued shift of retirement risks away from employers and toward individuals, the importance of that monthly inflation-protected Social Security benefit — something that can be counted on over a lifetime — becomes all the more important for future generations.

In my testimony today, I'd like to pose three questions. Is there a crisis in Social Security? Does privatization help to solve the long term Social security shortfall? Are proposals to drastically alter the Social Security benefit structure in the best interests of the young and the old? In a word, the simple answer to all three questions is no.

First, is there a financing crisis in Social Security? No. The Social Security financing shortfall is relatively modest and certainly manageable without drastic changes. The white hot rhetoric emanating from the White House on Social Security does a disservice to Social Security and to the American people.

Does Social Security face a long-term deficit? Of course. A doubling of the senior population will place strains on our financing system for Social Security. But let's put that deficit in proper context. The system is now generating very large surpluses — about $150 billion this year. It's been running surpluses for the past two decades and will likely stay in surplus for the next quarter century. The legislative changes enacted in 1983 provided stability for the system for more than half a century. This was a remarkable accomplishment.

Our growing aging population, however, will create further pressures over the long term. According to projections by the Social Security Trustees and the Congressional Budget Office, the Social Security trust fund will be exhausted in another forty to fifty years. And contrary to Administration rhetoric, the system will not be "bankrupt" at that time. Social Security revenues will still be sufficient to pay between 70% and 80% of today's benefit commitments.

This deficit over the next 75 years translates into about a half of one percent of GDP — somewhat higher according to the Trustees and somewhat lower according to CBO. And if one uses the Administration's preferred timeframe to measure the shortfall (into *eternity* — a ludicrous concept strongly criticized by the actuarial profession) the shortfall is still only a little over 1% of GDP.

Does this represent a long-term challenge? Of course. Does this represent a crisis? Of course not.

Some argue that not only are we in crisis but that the "crisis" starts in just 13 years, when payroll tax revenues may start to dip below benefit payments and the trust funds are tapped for some benefit payments. They argue that all that extra money coming in between 1983 and 2018 — about $5 trillion, and scheduled to grow by an additional 25% the decade after 2018 — represents "worthless IOUs" and therefore a crisis starting in 2018.

Modest trust fund payments don't represent a crisis. And I certainly hope that the holders of US Treasury securities in the US and around the world don't think of our Treasury bonds as worthless. If so, we have a much, much larger problem than simply strengthening Social Security's financing system.

If we had been paying down the debt with those Social Security surpluses, we would be in a much stronger position today to deal with the aging challenge. But even now, the trust funds help us in the long term. Thank heavens that we're raising that extra money. Without those funds the nation would be facing even larger economic challenge over the long term. The trust funds have been an essential component of Social Security financing for about 70 years, providing a check on both benefit expansions and revenue reductions. The biggest long term problem we face is not Social Security's growing or declining trust funds, it's the fiscal policies that lead to the large budget deficits.

It's certainly hard to come to terms with the real magnitude of these technical trust fund estimates, with projections in the trillions of dollars made over nearly a century. This is further complicated because Social Security's financing is tied to the federal budget. It's easier to understand the financing gap in relation to other big actions taken in Washington recently. The fact is that the tax cuts enacted over the past four years are about three times the size of the Social Security shortfall.

If Social Security represents a crisis, then what is the erosion of our tax base — Armageddon? Simply repealing the tax cut for the richest one percent of Americans would be the equivalent of resolving a large part of the Social Security shortfall — certainly a big step for the very rich but certainly not a crisis by my standards.

I've said for years that Social Security clearly faces a long term and manageable challenge, and it's a challenge that we should face up to sooner rather than later. The continued drum beat that we are hearing, however, about an imminent crisis and bankruptcy and Social Security hitting an iceberg all seems aimed at *eroding* support for our social insurance system and *building* support for radical restructuring of the program.

My second question relates to whether the radical restructuring that we are hearing about — the privatization of Social Security — will help to solve the long term Social Security shortfall. Absolutely not. Taking payroll tax revenues out of Social Security to create individual savings accounts makes the long-term problem bigger, not smaller. Unless benefits are drastically curtailed or other revenues raised, privatization only makes the financing problem worse.

If a portion of payroll taxes is redirected away from paying Social Security benefits, Social Security's financing is weakened by any of the measures I discussed earlier in my testimony. Rather than running surpluses for many years into the future, the system may start running deficits almost immediately. Rather than a problem that is about a half a percent of GDP over the next 75 years, the shortfall could easily be more than double this size. And rather than trust funds having resources for the next 40 to 50 years, the trust funds could be exhausted decades earlier.

It can be argued that the benefits of individual accounts may offset these added problems, but it does so by shifting more of the retirement risk on to individuals. With privatization, a growing share of retirement income will be based on the returns of the stock market. Certainly the markets can lead to high returns over time. But we all know that what comes up sometimes comes down. With privatization, trying to plan to retire in a time of down market conditions is a risky proposition.

Here again it is hard to come to terms with the implications of these big shifts in policies. Let me give you an example that I hope will shed some light on the potential implications of privatization. For years, I've listened to the supporters of privatization extol the virtues of the Chilean privatized system. During my years as Commissioner, I met the head of Chile's system during a major downturn in Chile's stock market. At the time, he was publicly urging older workers to delay retiring until the Chilean stock market came back so workers would not be forced into receiving inadequate annuities in retirement. This senior government official was urging older people to "just keep working" till the markets came back. I did not criticize his statements, because if I was in his position I would have done the very same thing, for the sake of the economic security of older Chilean workers.

Do markets bounce back quickly? Sometimes they do. And sometimes it takes many, many years for markets to come back. The problem, of course, is that we can't predict future market conditions. If we privatize a part of our Social Security system, we could find ourselves in the same situation as Chile. Frankly, I would hate to see a future US Social Security Commissioner urging America's older workers to "just keep working till the markets come back." Social Security ought to represent a foundation of support that can be counted on in retirement no matter what happens to the market.

Many argue that benefit commitments will have to be sharply curtailed if we privatize Social Security. This leads directly to my third question: whether drastic alterations in the Social Security benefit structure are in the best interests of current retires or young people. Again, the answer is no.

The Administration argues that current retirees will be unaffected by privatization proposals. I do not in any way question the sincerity of the White House on this matter, but the hard reality is that redirecting current payroll tax revenues erodes financing for Social Security, even if those revenues are somehow "made up" through general revenues and borrowing. These changes destabilize Social Security's financing. Privatization calls into question whether and how benefit commitments made to current retirees will be made in the years ahead. Large unified budget deficits could put real pressures on the benefit promises to current Social Security beneficiaries — maybe not today or tomorrow, but possibly over the next decade or so. Privatization is not in the best interests of current retirees.

What about future retirees? Will privatization, coupled with major alterations in the benefit structure be in their best interest? Again, the answer is no. The President's Social Security Commission suggested that changing over to a system of "price indexing" could resolve the financing problem that is generated by partial privatization. This idea of simply using "price indexing" to calculate future benefit payments sounds harmless enough. The supporters of privatization argue that future generations of beneficiaries would just be receiving the same level of Social Security benefits in real terms as current retirees.

Let's put price indexing in proper context. Social Security currently replaces about 40% of pre-retirement earnings. Financial planners indicate that to have adequate income in retirement, one should be able to replace 70% to 80% of pre-retirement income. Moving to a price indexing scheme lowers Social Security's "replacement rate" to nearly 20% over the next 75 years. And using the Administration's concept of projecting into "eternity," Social Security's replacement rate over time would approach nothing.

Again, it is hard to come to grips with the implications of price indexing and lowered replacement rates in the abstract. Let me provide another example that I hope will shed some light on the implications of price indexing on real people. We know that the Social Security retirement age for full benefits was increased in 1983 to age 67, with changes phased in over several decades. In other words, future generations will have to work until 67 if they want Social Security to replace the same level of earnings as persons retiring a few years ago. This was a very important change that received major attention and debate in the 1980s, as well it should have. It was widely understood that this change would significantly alter benefits for future generations, but many believed that the change was necessary given the long term demographic challenge that we face.

Now along comes this new possible change — price indexing — based on the argument that benefits for future generations will be about the same in real terms as present generations. In reality, however, price indexing is like the "stealth" cut in Social Security. Price indexing is comparable to an invisible increase in the retirement age for full Social Security benefits. Switching to price indexing in 2011 is equivalent to raising the retirement age for full Social Security benefits to age 71 for today's 35 year olds and raising it to 75 for children in pre-school today.

Changes of this magnitude are reckless and unnecessary as well as dangerous to the economic security of future generations.

Before closing, I would like to say that I have spoken out for many years now on the need to come together to keep Social Security strong for current and future generations. As you know, I was deeply involved as Commissioner in genuine bipartisan and nonpartisan discussions, forums and agency education efforts on Social Security.

During my tenure at the helm of the Social Security Administration, I was proud that the Agency greatly increased its efforts to educate the public in a purely nonpartisan way about how Social Security works and the long-term challenges that it faces. I can say that our nonpartisan education efforts were widely supported. There was no controversy within the Agency that we were somehow "politicizing" the Social Security issue. Indeed, I received numerous compliments on a bipartisan basis from Members of Congress for the exemplary education efforts undertaken by the Social Security Administration. I believe it is essential that our big public institutions be actively involved with the public, and I was very proud of the work of SSA's civil servants in these endeavors.

I'm concerned that this "crisis" discussion emanating from the White House takes us far away from clarity on this issue — and we seem to be getting further away by the day.

Senators, it's not only that a radical restructuring of Social Security is unnecessary, given the manageable size of the long term problem. Privatization also makes the financing problem that we face much worse. Privatization is not in the best interests of young and old alike — likely leading to drastic cuts in promised benefits for younger workers, as well as an erosion in Social Security's financing, which could also put the benefits of current retirees at risk over time.

Let's come together and solve a manageable problem, and not create a much bigger one by privatizing Social Security. And in the process, let's keep the word "secure" in Social Security.